(16)

No. 03-932

IN THE

Supreme Court of the United States

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JAMES C. BLAIR; JULIA R. BROWN; JOSEPH C. COOK, JR.; and MITCHELL R. WOODBURY,

Petitioners,

v.

MICHAEL BROUDO; BALDEV S. GILL; LARRY MORGAN IRA; LEONID SHVARTSMAN, (for G&S partnership); NEIL SISKIND; ROBERTA SPECK; BRENT VOGT, on behalf of themselves and all others similarly situated,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF BROADCOM CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT PURSUANT TO RULE 29.6

Pursuant to Supreme Court Rule 29.6, *amicus curiae* Broadcom Corporation states that it has no parent corporations and that there is no publicly held company that owns 10% or more of Broadcom Corporation's stock.

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BRIEF OF BROADCOM CORPORATION AS *AMICUS CURIAE* IN SUPORT OF PETITIONERS

This brief is filed on behalf of Broadcom Corporation as *amicus curiae* in support of petitioners, with the written consent of the parties.[1]

[1] As required by Rule 37.6 of this Court, *amicus curiae* submit that no party or counsel for a party to this case authored this brief in whole or in part, and no person or entity other than *amicus curiae* or its counsel has made a monetary contribution to the preparation or submission of this brief.

INTEREST OF *AMICUS CURIAE*

Broadcom Corporation ("Broadcom") is headquartered in Irvine, California and provides semiconductor solutions that enable broadband communications and networking of voice, video, and data services. Thus, Broadcom is one of the many technology companies located within the jurisdiction of the United States Court of Appeals for the Ninth Circuit. Like many technology companies, Broadcom has a volatile stock price—one that regularly rises and falls more than the stock market as a whole.

The Ninth Circuit's liberal and incorrect standard for pleading loss causation impacts Broadcom's ability to engage in efficient competitive behavior and its ability to raise capital to the detriment of the high technology sector of the U.S. economy. The Ninth Circuit's loss causation standard subjects Broadcom (and all other companies with volatile stock prices) to greater risk of liability in unfounded class action lawsuits seeking damages under Section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)") and Rule 10b-5 promulgated thereunder. Given the volatility in Broadcom's stock price, any stockholder who wishes to seek insurance for investment losses can at least for pleading purposes quite easily allege the element of loss causation following a purported material misrepresentation, as that element has been defined by the Ninth Circuit in *Broudo v. Dura Pharmaceuticals, Inc.*, 339 F.3d 933 (9th Cir. 2003), cert. granted, 124 S. Ct. 2904 (2004). In *Broudo* the Ninth Circuit held that mere allegations that a stock price was inflated at the time of purchase are sufficient to allege loss causation. This lenient standard increases the ability of plaintiffs to prosecute and potentially obtain artificially high damage awards in securities fraud lawsuits—especially against companies with volatile stock prices—even where the actual losses that are complained of are not caused by any misrepresentation or other wrongdoing by the company.

In contrast, the loss causation standard articulated by the Eleventh Circuit in *Robbins v. Koger Props., Inc.*, 116 F.3d 1441 (11th Cir. 1997) and the Second, Third, and Seventh Circuits (the "majority circuits") more sensibly requires stockholders to plead and prove a causal connection between a misrepresentation and an actual decline in the price of a company's stock. This standard facilitates more efficient competitive behavior on the part of companies, allowing them to take appropriate economic risks and raise capital to the benefit of the high technology and other sectors of the U.S. economy. With rising global competition, it becomes increasingly important to ensure that U.S. companies in the high-technology sector can effectively compete and increasingly important that this Court adopt the majority circuit's loss causation standard.

Broadcom has a further interest in this proceeding because it is currently a defendant in a securities class action lawsuit pending in the United States District Court for the Central District of California. The plaintiff recently submitted an expert report purportedly premised on—and definitely dependent upon—the Ninth Circuit's loss causation standard claiming damages in excess of $5.6 billion. It is no coincidence that the class period in the case is from July 31, 2000 through February 27, 2001—a period that overlaps with the collapse of the stock market in the U.S., and of the high-technology sector of the U.S. economy in particular. The liability issues in the case center around whether a non-cash accounting charge should have been classified as goodwill (as Broadcom was initially advised by its independent auditors) or as a charge against revenues (as the company and its auditors later concluded). The plaintiff, by submitting an expert report seeking damages of over $5.6 billion, is plainly attempting to recover losses that were caused by the general decline in the stock market, as the size of the reclassified non-cash charge during the class period was only $38.6 million. The disconnect between the damages claim in the plaintiff's

expert report and the liability issues would not even be arguably possible absent the Ninth Circuit's erroneous loss causation standard.

SUMMARY OF ARGUMENT

The loss causation element of Section 10(b) and Rule 10b-5 must answer the question why a stockholder lost money on an investment and not just why a stockholder made an investment. The standard applied by the majority circuits recognizes this important legal and economic principle while, at least at the pleading stage, the Ninth Circuit standard does not. The Ninth Circuit's rule that loss causation can be pleaded simply by alleging stock price inflation at the time of purchase obscures the primary importance of the actual stock price decline upon disclosure of the misrepresentation in establishing loss causation. If this rule were applied to measure recoverable damages, it would result in windfall damages to stockholders who have suffered no loss caused by a misrepresentation. Additionally, the current uncertainty in the law encourages plaintiffs to seek unfounded expert testimony on damages.

The potential windfalls resulting from the Ninth Circuit's standard are best illustrated by analyzing the damages awarded to in-and-out traders—*i.e.*, those who both purchase and sell stock before the "truth" is revealed. While in-and-out traders might lose money on an investment, their losses are not *caused* by the misrepresentation. By definition, in-and-out traders sell before the market learns of the purported fraud, and therefore any decline in the stock price between the purchase and sale by an in-and-out trader must have been caused by something other than the purported fraud. Nonetheless, class action plaintiffs and their counsel routinely argue that the Ninth Circuit loss causation standard allows in-and-out traders to recover damages. In contrast, the standard applied in the majority circuits—which emphasizes the stock price decline when the market learns of the misrepresentation—results in no such windfalls and compensates stockholders only for losses actually caused by a misrepresentation.

To ensure that stockholders do not recover damages for stock price declines that are not caused by any misrepresentation, this Court should reverse the decision of the United States Court of Appeals for the Ninth Circuit and hold that a stockholder must demonstrate an actual causal connection between a misrepresentation and a decline in the value of a stock in order to recover damages under Section 10(b) and Rule 10b-5.

ARGUMENT

I. PERSONS WHO PURCHASE AND SELL STOCK BEFORE THE MARKET BECOMES AWARE OF A MISREPRESENTATION CANNOT ESTABLISH LOSSES CAUSED BY THE MISREPRESENTATION

The different loss causation standards applicable in the Ninth Circuit and in the majority circuits directly impact the class of persons who can recover damages under Section 10(b) and how a plaintiff might prove that its losses were caused by a misrepresentation. Respondent claimed in its Supplemental Brief in Response to Solicitor General's Brief for the United States as Amicus Curiae ("Supp. Opp.") that damages for in-and-out traders are calculated the same way under both loss causation standards. *See* Supp. Opp. 1-2. This assertion is legally and economically incorrect.

An in-and-out trader purchases stock at an artificially inflated price, but also sells at an artificially inflated price. The inflation *caused* by the misrepresentation is not eliminated until the market learns of the misrepresentation either through a corrective disclosure by the company or otherwise. *See* Brief for the United States as Amicus Curiae 10-11 (May 2004); *Semerenko v. Cendant Corp.*, 223 F.3d

165, 185 (3d Cir. 2000) ("[i]n the absence of a correction in the market price, the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling the security at the inflated price"), cert. denied, 531 U.S. 1149 (2001); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1448 (11th Cir. 1997) (no evidence "price inflation was removed from the market price" before corrective disclosure); *see also In re Cendant Corp. Litig.*, 264 F.3d 201, 228 n.8 (3d Cir. 2001) (where "fraud was not revealed until after trading ended on April 15, 1998, [] the stock price before April 16 was at least as artificially inflated by the fraud . . . as it was at the purchase"), cert. denied, 535 U.S. 929 (2002). Thus, even if the stock price fell between the time of purchase and the time of sale, the in-and-out trader's loss is not caused by the misrepresentation. There could not have been a correction in the market price resulting from a correction of the misrepresentation because the market still knew nothing of the misrepresentation at the time of the in-and-out trader's sale. The in-and-out trader should not receive any damages.

The loss causation standard applicable in the majority circuits yields this economically correct result. The in-and-out trader in these circuits receives no damages because it cannot satisfy the loss causation standard which requires an actual causal connection between the decline in the price of the stock before the in-and-out trader sold and the misrepresentation. *See Bastian v. Petren Res. Corp.*, 892 F.2d 680, 684-85 (7th Cir. 1990), cert. denied, 496 U.S. 906 (1990); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1448 (11th Cir. 1997); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 185 (3d Cir. 2000), cert. denied, 531 U.S. 1149 (2001); *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 198-99 (2d Cir. 2003). In contrast, in the Ninth Circuit, the in-and-out trader may seek to recover damages even though its losses were not caused by the misrepresentation. The Ninth Circuit's loss causation standard can

be argued to require only that the stockholder allege that the market price was inflated at the time of purchase, and the in-and-out trader can often meet this standard. *See Broudo v. Dura Pharm., Inc.*, 339 F.3d 933, 938-39 (9th Cir. 2003), cert. granted, 124 S. Ct. 2904 (2004). Thus, the in-and-out trader in the Ninth Circuit recovers the artificial inflation in its purchase price when it sells its stock at the still inflated price and then may obtain a windfall if it receives damages in a securities class action.[2]

The differences between the standards are illustrated in the following hypothetical example:

- **Hypothetical**: Traders A and B purchased stock in Company X for $100 per share after Company X issued a press release containing misleading information. If Company X had not issued the misleading press release, its stock price on the date Traders A and B purchased would have been $90. Company X stock falls to $60 before the misleading press release is corrected. Company X stock then falls an additional $10 per share immediately after Company X issues a press release correcting its earlier misleading press release. Trader A sold its stock at $50 after Company X's corrective disclosure while

[2] This discussion assumes that the in-and-out trader sells its stock before there is any correction in the market price of the stock caused by the misrepresentation. If, however, an in-and-out trader sells after a partial correction in the market price (due, for example, to a partial disclosure of the prior misrepresentation) but before complete correction of the market price, the in-and-out trader can demonstrate some loss caused by the misrepresentation. Of course, a stockholder who purchased at the exact same inflated price as the in-and-out trader and sold only after a complete correction in the market price would still suffer greater losses caused by the misrepresentation than the in-and-out trader. Even in this situation, the loss causation standard applied by the majority circuits yields the correct result while the Ninth Circuit standard might overcompensate the in-and-out trader.

Trader B sold its stock at $80 before Company X's corrective disclosure.

- **Majority Circuits:**
  - Trader A receives damages of $10 per share because Trader A can demonstrate an actual causal connection between the $10 decline in value of Company X stock and the misrepresentation given that Company X's correction of its misleading press release caused the stock price to fall $10.
  - Trader B receives no damages because Trader B cannot establish an actual causal connection between the misrepresentation and the decline in value between its $100 purchase price and its $80 sale price. Company X's stock fell from $100 to $80 for reasons unrelated to the misrepresentation and thus Trader B's losses were not caused by the misrepresentation.[3]
- **Ninth Circuit:**
  - Trader A will argue that it should receive damages of $10 per share because the market price on its date of purchase was inflated by $10 per share.
  - Trader B will also argue that it should receive damages of $10 per share because the market price on its date of purchase was inflated by $10 per

[3] Even if the amount of the artificial inflation was lower at the time Trader B sold than at the time it purchased, Trader B's loss was not caused by the fraud (which was still unrevealed). Loss causation must serve to limit recoverable damages to those that actually result from the fraud. *See, e.g.*, 15 U.S.C. § 77k(e) (defining damages for a violation of Section 11 of the Securities Act of 1933 but limiting "recoverable" damages to those actually caused by the misrepresentation).

share. Even though Trader B's loss was not caused by the misrepresentation, Trader B might receive damages and a windfall of $10 per share.[4]

The differences in the loss causation standards are also nicely illustrated by comparing the hypothetical case presented in the Ninth Circuit's decision in *Wool v. Tandem Computers Inc.*, 818 F.2d 1433 (9th Cir. 1987) with the Seventh Circuit's decision in *Bastian v. Petren Resources Corp.*, 892 F.2d 680 (7th Cir. 1990). In *Wool*, the Ninth Circuit presents an example where a company issues a misleading statement indicating that it has discovered oil when in fact it has not, causing its stock price to increase by $10. Thereafter, a different company announces its own discovery of oil causing a decrease in the price of oil and a resulting $5 decline in the price of the first company's stock. The Ninth Circuit states that an in-and-out trader who sold before the fraud was revealed but after the decline in the price of oil suffered a recoverable loss of $5. *See Wool*, 818 F.2d at 1437 (citing *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1345-46 & nn.6-10 (9th Cir. 1976)). In contrast, in *Bastian*, the Seventh Circuit held that persons who invested in oil and gas limited partnerships failed to establish that their losses were caused by fraud when the value of the partnerships fell because of a worldwide decline in the price of oil. *See Bastian*, 892 F.2d at 684.

[4] The potential windfall to in-and-out traders from the Ninth Circuit's loss causation standard (if applied to measure recoverable damages) not only adversely impacts defendants in securities class actions, but given that most securities class actions are settled before trial, also reduces the funds available to satisfy claims by non in-and-out traders who must share any settlement proceeds with in-and-out traders. Thus stockholders who actually suffered losses caused by a misrepresentation would obtain smaller recoveries because some funds would be distributed to in-and-out traders who did not suffer losses caused by a misrepresentation.

The decision in *Bastian* is correct. At the time of its sale, the hypothetical stockholder in *Wool* thought it owned exactly what it thought it owned when it purchased – stock in a company that had recently discovered oil. The stockholder voluntarily took the risk that the price of oil would fall, and oil prices fell for reasons not related to the alleged fraud. Even if the company had been exactly as represented (*i.e.*, it had discovered oil) its stock price would still have fallen and the hypothetical stockholder would still have lost the $5 resulting from the market decline. Thus, the hypothetical stockholder's $5 loss was not caused by the misrepresentation.

These examples help demonstrate the incoherence of the Ninth Circuit's loss causation standard which might award windfall damages to stockholders who have not suffered any investment losses caused by a misrepresentation. The standard applied by the majority circuits in contrast ensures that stockholders receive compensation only for losses actually caused by the misrepresentation.[5]

II. LOSSES CAUSED BY A MISREPRESENTATION SHOULD BE MEASURED BY THE DOLLAR DECLINE, AND NOT THE PERCENT DECLINE, WHEN THE MARKET LEARNS OF THE MISREPRESENTATION

By permitting plaintiffs to plead loss causation based solely on a showing of inflation at the time of purchase, the Ninth Circuit's loss causation standard exacerbates another economic anomaly in measuring recoverable damages. Losses

[5] Of course, the inflation in the stock price at the time of purchase provides a cap on the damages that a stockholder can recover under Section 10(b) and Rule 10b-5 in order to limit damages to out-of-pocket losses. For example, if a stockholder overpays $10 when it purchases stock and the stock price falls $20 on disclosure of the fraud, the stockholder's maximum recovery is $10, its out-of-pocket loss.

caused by a misrepresentation should be measured by the dollar decline when the market learns of a misrepresentation. Using the percent decline as opposed to the dollar decline leads to perverse results. Regardless of whether a company's stock price rises or falls during the class period, the percent method can distort the determination of damages. For example, the percent method can lead both to awards of damages to stockholders who suffered no losses caused by a misrepresentation and to different treatment of stockholders whose actual losses caused by a misrepresentation are the same.

Plaintiffs' experts generally use what is termed the constant percent method or percent method to estimate the losses caused by a misrepresentation. The constant percent method assumes that a misrepresentation inflates the market price of a stock by the same percent regardless of the stock price. Thus, if the percent inflation caused by a misrepresentation is 17% and the stock price is $100, then the dollar inflation caused by the misrepresentation in the stock price is $17.00 (17% of $100). If, however, the price of the stock falls to $80 for reasons unrelated to the misrepresentation, the constant percent method assumes that the dollar inflation caused by the misrepresentation is $13.60 (17% of $80).

The constant percent method results in windfall damages to certain stockholders because it fails to limit awards to losses *caused* by a misrepresentation. This windfall is illustrated by analyzing Trader B's damages in the hypothetical from Section I. As discussed above, Trader B (the in-and-out trader) both purchased and sold before disclosure of Company X's misrepresentation. Thus, Trader B cannot establish a causal connection between its losses and Company X's misrepresentation and should not recover damages. Under the constant percent method, however, Trader B could receive windfall damages. Trader B will claim that the price of Company X stock fell from $60 to $50 (or 17%) upon correction of the misrepresentation. Thus using the constant

percent method, Trader B will argue that it paid $17 per share in artificial inflation when it purchased Company X stock (17% of the $100 purchase price) and only recouped $13.60 in artificial inflation when it sold Company X stock (17% of the $80 sale price). Thus, under the constant percent method Trader B will claim damages of $3.40 per share even though none of its losses were caused by the misrepresentation.

The constant percent method also results in incorrect damage recoveries to stockholders who buy stock and hold it long-term. Suppose an example where two stockholders purchased Company Y stock during a period when Company Y stock is artificially inflated by a misrepresentation. One stockholder purchased the stock at $100 while the other stockholder purchased the stock at $200. The reason for the difference in the purchase prices for the two stockholders was not related to the misrepresentation. After the revelation of the misrepresentation, Company Y's stock price fell from $50 to $40 (20%). Neither of the two stockholders sold their stock. Under the constant percent method, the stockholder who purchased at $100 will argue that it should receive damages of $20 per share (20% of the $100 purchase price) while the stockholder who purchased at $200 will argue that it should receive damages of $40 per share (20% of the $200 purchase price). This result is inconsistent with loss causation because both stockholders suffered the same damages caused by the misrepresentation, *i.e.* $10 per share. The percent method is flawed because it overcompensates both stockholders in this example and because it awards different recoverable damages to stockholders who suffered precisely the same loss.

The only way to measure the decline in value *caused* by a misrepresentation (and not to award windfall damages to persons whose losses were not caused by a misrepresentation) is to use the dollar (not the percent) decline in value when the market learns of the misrepresentation. The dollar decline

provides an objective measure of the real-world losses caused by a misrepresentation. This, in turn, will reduce the extent to which damages analysis becomes a battle of experts in a field involving highly technical statistical and econometric studies which courts and juries are ill equipped to understand and apply. It also measures damages based on the actual losses caused to stockholders when they learn that they had not purchased what they thought they had purchased. Of course, one cannot simply use the gross dollar decline on the day a misrepresentation is corrected because that decline includes market, industry, and company specific factors not related to the misrepresentation. The dollar decline that should be used to calculate damages caused by a misrepresentation must be a statistically significant residual dollar decline after taking into account market, industry, and company specific factors unrelated to the alleged fraud. The loss causation standard applied by the majority circuits properly recognizes these principles by measuring loss based on the actual decline in stock price caused by a misrepresentation while the Ninth Circuit standard arguably does not.

CONCLUSION

The examples presented in this brief demonstrate that the different loss causation standards applied by the majority circuits on the one hand and the Ninth Circuit on the other hand are not mere "semantic" differences as Respondents state. *See* Response in Opposition to Petition for a Writ of Certiorari 13. The loss causation element prevents Section 10(b) and Rule 10b-5 from "becom[ing] an insurance plan for the cost of every security purchased in reliance upon a material misstatement or omission." *Huddleston v. Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. 1981), aff'd in part, rev'd in part, 459 U.S. 375 (1983). The Ninth Circuit standard could result in windfall benefits that are economically unjustified and legally incorrect, while the standard applied by the majority circuits ensures that

stockholders are compensated only for damages actually caused by misrepresentations and not for declines in stock prices that were not caused by misrepresentations.

The decision of the United States Court of Appeals for the Ninth Circuit should be reversed.

Respectfully submitted,

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